Before the
Federal Communications Commission
Washington, D.C. 20554

In the matter of	)	
	)	
Federal-State Joint Board on	)	
Universal Service	)	CC Docket No. 96-45
	)	
	)	
	)	

Reply Comments on Notice of Proposed Rulemaking by

Maine Public Service Commission,

Montana Public Service Commission, and

Vermont Public Service Board

Contents

1. INTRODUCTION

The Maine Public Service Commission, the Montana Public Service Commission and the Vermont Public Service Board ("Rural State Commissions") respectfully submit the following Reply Comments on the questions raised in the Commission's Notice of Proposed Rulemaking (FCC 02-41).

2. VERIZON'S COMMENTS

A. Fund size. Verizon correctly asserts that the Commission must balance all of the statutory goals set forth in subsection 254(b). However, Verizon then asserts that a universal

service fund that is too large would "adversely impact the principle that '[q]uality services should be available at just, reasonable and affordable rates.'"[1] Later, Verizon states that "Assessments . . . are passed on to consumers, affecting the affordability of telephone service for customers in all areas."[2] Verizon asserts that certain actions by the Commission would create a "huge demand" on the fund that would create a "significant threat to affordability of telephone service."[3]

Verizon's argument fails to recognize that the USF support is not only collected, but it is distributed. The funds that are raised from customers in all areas are distributed to high-cost areas. Thus assuming that higher rates are less affordable, the larger and more ambitious the fund, the more it *promotes* affordability.

Verizon's comment is understandable only from the narrow point of view of a low-cost customer. Since a low-cost customer does not benefit from support distributions, any increase in support will have the sole effect of increasing that customer's cost. That could, conceivably, reduce affordability for that customer. But axiomatically the harm is *less* than the matching benefit of enhanced affordability for high-cost customers. Thus Verizon essentially argues that the Commission should keep the fund small because any fund raises the net cost to some customers. Verizon is essentially opposing the very existence of § 254. It has made no showing that a sufficient fund will make low cost customers rates unaffordable. Verizon's argument must be rejected since section 254 explicitly requires a contribution from all customers, including those who do not stand to gain from support distributions.

Verizon might wish that section 254 had included a principle that limits fund size and thus protects Verizon's many low-cost customers from having to contribute more than they

[1] Verizon comments at 3.

would like. However, no such statutory limitation exists, and the Commission cannot invent one. As we stated in our initial comments, no principle of section 254 sets up limiting fund size as a competing principle against the "sufficient" and "reasonably comparable" standards.

B. Comparable Rates. Verizon refers to the General Accounting Office report in support its conclusion that urban and rural rates are reasonably comparable today.[4] Based on that GAO study, Verizon reports that nearly all rates nationwide are within two standard deviations of the mean.[5] Unfortunately, this observation does not provide any guidance since it is a tautology. For any normally distributed data set (and for most others that are not normally distributed), it is *always* true that about 98 percent of the cases are less than two standard deviations above the mean.[6] Thus Verizon's observation does not support its conclusion that rates are reasonably comparable today.

Second, Verizon recites that the telephone subscription rate nationally is 95.1 percent. While the national subscription rate is high, that fact is irrelevant here. The comparability standard here is whether rural rates are reasonably comparable to urban rates, not how many people have telephone service. Subscribership is an indication of affordability not comparability.

The General Accounting Office study is not helpful in this proceeding, and the Commission should not rely upon it.[7] There are three fundamental problems with the report's data and conclusions:

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[2] Verizon comments at 3.
[3] Verizon comments at 7.
[4] Verizon comments at 4-6.
[5] Verizon comments at 6.
[6] This figure is based upon a one-tailed analysis, which is appropriate because the question is how many customers have rates above a point that is two standard deviations above the mean. All cases below the mean satisfy this test.
[7] AT&T's comments also mention the GAO study.

1. The GAO study was based upon tariffed rates, and thus it failed to control for non-price factors that affect the value of local exchange. Notably absent was any consideration of local calling area size and what features or services are included as part of a local exchange service. Urban customers often have large calling areas, both on a geographic basis and on a number of telephones-reached basis. Also various states or companies may include different features as a part of local service. This biases the result since different urban rates include different amounts of service. In other words, urban customers may typically get more for their monthly local exchange payment.[8] Service quality also varies by company and within companies, although the GAO report fails to reflect that variation. Calling area and scope of service are important differences in the meaning of local exchange rates. Conclusions regarding comparable rates are not reliable unless they adjust for these differences.
2. The GAO study selected communities for study without regard to whether they were served by rural carriers or non-rural carriers. Thus the study failed to measure any rate differences that may result from the two systems that the Commission has established for support of nonrural (large) and rural (small) carriers. Since this remand proceeding is only about nonrural carriers, the GAO study did not make the fundamentally important comparisons between the rural customers and urban customers of nonrural carriers. It is possible, for example, that there is a difference between the average rates of rural customers served by large carriers and the average rates of rural customers served by small carriers. If so, the GAO study did not account for that difference, even though the

[8] In many cases rural customers must pay significant toll charges in addition to the local exchange rate to receive a calling scope equal to urban customers.

magnitude of that difference might amount to a section 254 violation. Thus the GAO study does not meet the test of legal relevance in this proceeding.

3. Finally and most significantly, the GAO study failed to express any opinion at all on the central issue here: whether rural rates in some areas are so high that they are not reasonably comparable to urban rates. It is quite possible for the national average rate in urban areas and the national average rate in rural areas to be exactly the same, and still to have large localized violations of rate comparability. What matters is whether there are *any* rural customers whose rates (or costs) are substantially higher than the average urban customer.[9] For example, the GAO study reports that residential rates in Jeffersonville, Vermont are $24.55 per month. The mean central city rate, according to the study, is $14.79. This represents a difference of 66 percent, and is outside the limits of reasonable comparability. For this reason alone the GAO study cannot support the proposition that urban and rural rates are comparable.

C. Benchmark. Verizon suggests using a cost benchmark based on two standard deviations from the nation wide average cost per line.[10] This proposal has three fundamental problems. First, it suggests comparing the wrong things. The statutory standard requires comparability to *urban* rates, not to the nationwide average.

Second, as noted above, Verizon's argument is totally circular, with no underlying substantive import. Verizon asserts that "the vast majority of rates fall within two standard deviations of the mean." This is simply a statement that defines the characteristics of a normally distributed set of data (and most other distributions as well). It cannot provide any guidance on

[9] Consistent with our earlier comments, we believe that a suitable division of responsibility between the Commission and the states would allow the Commission to ignore rate differences within the states and to use statewide average rates as the "rural" rate. Nationwide averaging, however, presents completely different issues.

[10] Verizon Comments at 8.

the selection of an appropriate benchmark. "Two standard deviations" is actually no more than a totally arbitrary round number expressed in the form of a statistic.

The third problem with Verizon's recommendation is that a difference of two standard deviations is quantitatively too large to comport with any plausible definition of "reasonably comparable." In a normal distribution, 97.7 percent of the cases are less than a standard deviation of plus 2.0.[11] Thus if Verizon's suggestion were accepted, no support would be available unless a rural customer's rates (or costs) exceeded those of *nearly all* (i.e.: 97.7 percent of) urban customers' rates (or costs). This is not reasonable and was not what Congress had in mind for reasonably comparable rates. For just a simple example, no reasonable person would assert that his income is "reasonably comparable" to the national average if it is lower than 98 percent of all citizens or higher than 98 percent of all citizens. "Two standard deviations" is actually no more than an arbitrary number that would allow the Commission to continue providing a small amount of support to the rural customers served by large carriers.[12]

Verizon suggests that its test of two standard deviations be applied to cost figures. The danger in its suggestion becomes apparent, however, when the test is applied to the very rate data that Verizon cites elsewhere in its comments in support of its conclusion that rates are reasonably comparable. The GAO study reported residential central city rates of $14.79 and a standard deviation of $5.31. That means Verizon's test would allow residential rural rates to be no more than:

$14.79 + (2 x $5.31) = $25.41

[11] As noted above, a one-tailed test is appropriate here because the question is how many customers are below the single point defined as the mean plus two standard deviations.

[12] If there any doubt remains about whether Verizon's proposal is aimed at justifying the existing 135% figure, it is worth noting that Verizon's analysis actually produces a benchmark of 132%. Verizon then suggests that this is "approximately" equal to the current benchmark of 135%. In fact, there are significant financial differences between a benchmark of 132% and 135%.

But $25.41 is 72 percent greater than $14.79. This is within the range of differences which the Tenth Circuit said that it doubted would be comparable.

3. AT&T'S COMMENTS

A. Sufficiency. AT&T alleges that the principal question in this remand proceeding is whether the Commission's benchmark of 135 percent of the national average cost provides "sufficient" support in addition to the state's own effort in order to ensure affordable rates.[13] It then incorrectly concludes that the existing benchmark provides sufficient support since under that plan support is greater than the support previously provided to nonrural carriers.

AT&T's reasoning seems to be that the Commission has already found support sufficient to ensure affordability, and the present system is "more generous" than the previous system, so therefore the present system is sufficient.[14] That argument fails because the Commission never found that the previous pre TelAct support system met the affordability requirements imposed by the TelAct. AT&T's argument also fails because it assumes that "affordability" is the sole requirement for sufficient support under section 254. AT&T fails to recognize that it was the *comparability* of rates that was challenged in the Tenth Circuit appeal and that needs to be explained here. Contrary to AT&T's suggestion,[15] even if rates are everywhere affordable, that does not establish sufficiency for the purposes of section 254.

Likewise, AT&T points out that penetration rates in the United States are high.[16] Once again, however, while this is encouraging, it does not help establish that rates are reasonably

[13] AT&T Comments at 5.
[14] AT&T Comments at 6.
[15] AT&T Comments at 9.
[16] AT&T Comments at 7.

comparable between urban and rural areas. Support is insufficient if it permits rates in any state to remain at levels not reasonably comparable to urban rates.

B. Measuring Urban Rates. Vermont and Montana had suggested to the Tenth Circuit that urban rates could be defined as equal to the average forward-looking cost in large wire centers. AT&T criticizes such a methodology and suggests that "statewide average cost is the appropriate proxy for both urban and rural rates within each state." The rural state commissions are not entirely sure what this means, but we may agree with the first part of the definition.

We agree that in defining "rural" costs, the Commission may use a rural state's average cost. States can use their own resources for a portion of the effort of making rural rates comparable. This is true in high-cost states because statewide averaging (either explicit or implicit) offsets high rural costs with urban costs within the state. If the average cost is reasonably comparable to urban, the state can take care of differences within its boundaries. The allocation of responsibility between the states and the Commission allows for statewide averaging of rural rates.

However, AT&T seems to suggest that state-to-state comparisons are appropriate to measure urban costs. AT&T suggests that urban may be defined by study area costs, or possibly by averages of multiple study areas found in a single state.

The problem once again, however, is what is meant by the word "urban." As far as petitioners are aware, all of the study areas operated by nonrural carriers, but one, contain some rural areas. It is impossible to ascertain the level of "urban" rates or costs by measuring the characteristics of study areas containing both urban and rural areas. Even large states like New York and California contain large high-cost rural areas, thus producing a higher study area average cost than that of an urban areas alone. The use of study area averages will produce a

base cost that is not driven only by urban costs but by the mix of costs of a state's urban and rural areas. The use of averaged not urban costs is an erroneous way to implement the statute.

The one exception is Verizon's study area in the District of Columbia. That study area (and jurisdiction) appears to be the one nonrural study area that is entirely or almost entirely urban. If the Commission decides to define "urban" costs based on a study areas or a states, as suggested by AT&T, it should then base "urban" costs on the Verizon D.C. study area.[17]

C. Past or Future Rate Differences. AT&T suggests section 254(b)(3) was not intended to remedy a lack of comparability that existed prior to 1996,[18] or, if it was, then only for rural companies.[19] AT&T appears to argue that universal service support was intended to cover the future deaveraging of intrastate rates, and it was intended to cover existing cost and rate disparities for small companies, but somehow existing disparities for large companies were intentionally omitted.

The history of high cost support issues is more complex than AT&T reports, and something very like the present issue has been before the Commission since well before the passage of the 1996 Act. The Vermont Public Service Board and Vermont Department of Public Service filed a petition for waiver with the Commission in September, 1993. The petition asked for a waiver to allow Vermont to receive support equal to what would have been available if Verizon's predecessor in Vermont had fewer than 200,000 lines.[20] Action on Vermont's waiver request was postponed to initiate a comprehensive review in 1994. The comprehensive review began

[17] As we noted in our original comments, Verizon D.C's forward-looking cost is lower than the urban average we calculated using wire center size.

[18] AT&T Comments at 12.

[19] AT&T Comments at 9 (citing former Commissioner Furchgott-Roth).

[20] In the Matter of Waiver of Section 36.631 of the Commission's Rules Governing the Universal Service Fund, *Petition for Waiver of the Vermont Department of Public Service and the Vermont Public Service Board*, (AAD-93-103), filed September, 1993.

with a Notice of Inquiry [21] and was followed by a Notice of Proposed Rulemaking in 1995.[22] That comprehensive review was still pending when the Telecommunications Act of 1996 became law. Thus the question of the adequacy of support for customers of large nonrural companies has been before the Commission almost continuously for nearly nine years. Significantly, the Commission never found that the previous support plan met any statutory criterion similar to the comparability and affordability requires of § 254.

The full answer to AT&T's assertion, however, is simply that it is without any statutory basis. Section 254 does not say that the customers of small companies should get preference over the rural customers of large companies. Nor does it say that post-1996 rate disparities are more worthy of support than pre-1996 rate disparities. Moreover, AT&T's statement conflicts with the 10th Circuit's remand order. It would have been meaningless to require the Commission to articulate a standard for "sufficient" support and "comparable" rates if those standards somehow did not apply to protect the rural customers of large non-rural carriers.

4. MASSACHUSETTS DTE COMMENTS

The Massachusetts Department of Telecommunications and Energy ("MDTE") the MDTE urged the Commission to condition federal universal service support upon a high-cost state developing and implementing mechanisms to support universal service within that state's borders.[23] Specifically, the MDTE recommends that the Commission require state universal service mechanisms to cover a portion of the difference between the national cost benchmark and

[21] Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Notice of Inquiry*, 9 FCC Rcd 7404 (1994)

[22] That NPRM explicitly asked whether the Commission should reconsider its rules that gave "significantly preferential treatment" to study areas with 200,000 or fewer loops. Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Notice of Proposed Rulemaking and Notice of Inquiry*, FCC 95-282, para. 40 (July 13, 1995).

[23] MDTE Comments at 3.

statewide average costs before Federal USF support is provided.[24] The MDTE offers two reasons for this recommendation. Both are flawed.

First, the MDTE lists two payee states, Maine and Vermont, that have higher penetration rates than Massachusetts. MDTE then notes that Maine and Vermont receive high cost support, while Massachusetts does not. MDTE asserts the result is an inequitable distribution of the burden of supporting universal service programs.

The MDTE has failed to recognize, however, the difference between telephone penetration and telephone rates. Telephone customers in all states pay for universal service programs, including customers in states with low penetration levels. Congress did not exempt customers in low-penetration states from the obligation to contribute to universal service. On the distribution side, the support goes to states with high costs. Since Massachusetts is not a high-cost state, it does not receive support. It is noteworthy that the MDTE did not allege that rates or costs are lower in Maine or Vermont than in Massachusetts. Rural state commissions see nothing inequitable here.

Second, the MDTE asserts that in the absence of such state programs, high-cost states would rely upon federal funding to subsidize all customers within their borders, and thus, place the burden of universal service on other payor states.[25] In another place, MDTE asserts that states should be required to pay a "set percentage of the costs" of making rates comparable. By agreeing that statewide average costs should be compared to urban costs, the Rural State Commissions implicitly agree that states may reasonably be expected to support cost variations within their borders.

[24] MDTE Comments at 6.
[25] MDTE Comments at 3.

However, the MDTE does not explain how states with high average costs can, through a state effort, solve their high cost problem. Any levy for a universal service fund would redistribute money within the state, but every dollar spent to reduce effective cost must first be raised through the state's universal service levy. A state cannot reduce its own average costs. Indeed, it was for this reason that the Commission in 1999 reversed itself and rejected a similar "75-25" support sharing policy that had originally been adopted in 1997.[26]

Thus the MDTE recommendation amounts to asserting that states should solve a "set percentage" of a fiscal problem that it is financially impossible to solve. This would be a clear violation of the Commission's obligation to provide sufficient support.

5. INDUCEMENT COMMENTS

Under the guise of inducements, numerous commenters suggested placing conditions on the receipt of federal universal service and Lifeline funds. The Rural State Commissions oppose conditions. The Tenth Circuit did not intend that conditions be established, and conditions could create insufficient support and violate section 254. If inducements are punitive "sticks," they will ultimately have an adverse impact on rates for high cost customers and, in turn will jeopardize the very purpose of universal service. If certain parties have their way, then support would be withheld, and high cost customers would be punished with higher prices.

[26] In 1999, the Commission stated that:
"We explicitly reconsider and repudiate any suggestion in the First Report and Order that federal support should be limited to 25 percent of the difference between the benchmark and forward-looking cost estimates, in favor of the more nuanced" balancing of federal and state responsibilities outlined by the Joint Board. To the extent a state's

Respectfully submitted,

s/ Joel Shifman
Joel Shifman, Esq. for
Maine Public Utilities Commission
24 State Street
18 State House Station
Augusta, ME 04333

s/ Martin Jacobson
Martin Jacobson, Esq., for
Montana Public Service Commission
1701 Prospect Avenue
PO Box 202601
Helena, Montana 59620-2601

s/ Peter Bluhm
Peter Bluhm, Esq., for
Vermont Public Service Board
112 State Street, Drawer 20
Montpelier, Vermont 05620-2701

resources are deemed inadequate to maintain affordable and reasonably comparable rates, the federal mechanism will provide the necessary support." CC Docket No. 96-45, *Seventh Report and Order*, May 28, 1999, para 3.